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**M E M O R A N D U M**

**TO:** All Retirement Boards

**FROM:** Robert F. Stalnaker, Executive Director

**RE:** Investment Regulations

**DATE:** July 14, 1998

PERAC's revised Investment Regulations are now in effect. This memo is designed to review with you those aspects of the Regulations that may require the Board to take immediate action. In addition this will instruct Boards as to how to comply with the Regulations in the selection of managers and consultants.

One of the significant reforms embodied in the Regulations is the establishment of terms and conditions to be included in a written contract between the Boards and investment managers. Outlined in 840 CMR 16.02 (5) these include:

1. Employment of an investment manager must be by a written contract executed prior to the delegation of investment authority to the manager.
2. That contract must include all the terms and conditions governing the relationship between the Board and the manager.
3. The contract must include:
  - a. the objectives to be achieved by the manager ( example, if the manager is a domestic equity value manager - S&P 500 + 100 basis points)
  - b. brokerage practices
  - c. proxy voting and tender offer exercise procedures (who will be responsible – what direction should the Board provide the manager)

MEMORANDUM - Page Two

TO: All Retirement Boards  
FROM: Robert F. Stalnaker, Executive Director  
RE: Investment Regulations  
DATE: July 14, 1998

- d. fees – the fees must be part of the written contract and the Board should fully understand the fee structure prior to execution of the contract
  - e. termination provisions – generally the contract may be terminated by either party with 30 days notice
- 4. The contract must include a provision stating that the manager is a fiduciary with respect to the funds the manager is investing
  - 5. The contract shall not contain a provision that requires the indemnification of the manager by the Retirement Board.

Boards are advised to review their existing arrangements with managers and to amend those arrangements as necessary in order to comply with these Regulations.

Similarly, 840 CMR 26.01(4)(b) requires a written contract governing the relationship between Retirement Boards and consultants. That contract must include the following:

- 1. An itemized list of services to be provided by the consultant.
- 2. Fees (pursuant to 840 CMR 26.01(5) fees must be based on a fixed dollar amount and may not be based on a percentage of asset value)
- 3. Termination provisions – generally the contract may be terminated by either party with 30 days notice

Furthermore, no contract shall contain a provision requiring indemnification of the consultant by the Retirement Board.

Boards are advised to review their existing arrangements with consultants and amend those arrangements as necessary in order to comply with these Regulations.

As you may be aware these Regulations have dramatically revised the “waiver process”. The details of those changes will be reviewed below. Boards must, in all circumstances comply with the following Regulations:

- 1. Under 840 CMR 16.08 the procurement of all investment related services must take place by a competitive process that satisfies the Boards’ fiduciary duty and complies

MEMORANDUM - Page Three

TO: All Retirement Boards  
FROM: Robert F. Stalnaker, Executive Director  
RE: Investment Regulations  
DATE: July 14, 1998

with Chapter 32 and Regulations. **Prior to the retention of an investment manager, consultant, custodian bank or other investment related service provider a Board must notify PERAC that a competitive process was followed and that Chapter 32 and Regulations were complied with in making the selection. (see also 840 CMR 19.01 (11))**

2. Boards must maintain a file for each selection that contains the RFP, a copy of each response to the RFP, selection process, selection criteria, contract, with any addendum, and other relevant material.
3. Any vendor submitting a bid or proposal must submit to the Board the certification outlined in 840 CMR 16.08. (See attached copy).

Pursuant to 840 CMR 17.03 Retirement Boards must forward to existing managers and all future managers a copy of the Code of Ethics and Standards of Conduct set forth in 840 CMR 17.02 and 17.04.

In accordance with 840 CMR 17.04 (8)(a) managers and consultants must disclose to PERAC and to the Board any compensation arrangements that the manager or consultant may have with other parties in relation to the services provided to the Board.

In accordance with 840 CMR 17.04(8)(b) managers and consultants must disclose any compensation paid or expected to be paid by the manager or consultant or a related person to others for referring services of the manager or consultant to the Board.

PERAC requires the disclosures under 840 CMR 17.04 (8) (a) and (b) to be made prior to the hiring of the manager or consultant. Also, such disclosures must take place during the term of the relationship with the Board if circumstances warrant. It should be noted that PERAC takes a broad view of compensation arrangements that is not limited to direct payment. Such arrangements can include brokerage commissions and even assistance in obtaining clients. **Until revised forms are provided to Boards existing forms should be used.**

The "waiver" process itself has undergone significant revision under the revised Regulations. Again, in spite of these changes the Board **must submit disclosures and certification of a competitive process prior to retaining a manager or consultant regardless of whether or not a "waiver" (now referred to as an exemption) must be granted.**

MEMORANDUM - Page Four

TO: All Retirement Boards  
FROM: Robert F. Stalnaker, Executive Director  
RE: Investment Regulations  
DATE: July 14, 1998

Pursuant to 840 CMR 19.02 (5) in the event a Board has selected a investment manager to invest assets in fixed income securities or equities of United States Corporations an exemption is not necessary. However as noted the competitive process certification and disclosures must be filed in all cases.

In accordance with 840 CMR 19.01 a Board that has in the past received a “waiver” for a particular asset class and that, **following a competitive process**, selects a manager or fund that has been the subject of a “waiver” in the past, may retain that manager or invest in that fund without receiving an exemption. **However, the Competitive Process Certification as completed by the Board, the Procurement Form as completed by the manager and Disclosures must be filed with PERAC prior to retention of the manager or investment in the fund.** PERAC will create and maintain a list of those managers and funds that have been the subject of an exemption. (For example Board X has received a “waiver” or an exemption to invest assets through the ABC International EAFE Index Equity Fund. The Board decides to invest assets in international emerging market growth stocks. **Following a competitive process Board X selects the XYZ Emerging Market Fund. The XYZ Emerging Market Fund has been the subject of an exemption obtained by Board Z and appears on the PERAC list. Board X need not apply for an exemption but must file the Competitive Process Certification as completed by the Board, the Procurement Form as completed by XYZ Emerging Market Fund and Disclosures with PERAC. Upon notice from PERAC that this information has been received Board X may proceed with the investment.**) It should be noted if Board X has not received a “waiver” or exemption for the asset class i.e. international equity, an exemption is necessary regardless of the fact that XYZ Emerging Market Fund has been the subject of a “waiver” or exemption granted to another system and appears on the PERAC list.

The result of these revisions is as follows:

1. An exemption (term for “waiver” in the new regulations) is necessary in these circumstances:
  - a. A Board, **following a competitive process**, selects a manager/fund to invest in an asset class in which the Board has not previously invested and thus, not

MEMORANDUM - Page Five

TO: All Retirement Boards  
FROM: Robert F. Stalnaker, Executive Director  
RE: Investment Regulations  
DATE: July 14, 1998

previously received a “waiver” or exemption for that asset class.

- b. A Board, **following a competitive process**, selects a manager/fund **to invest in non domestic fixed income or equity securities** that has not been the subject of a previous “waiver” or exemption and does not appear on the PERAC list.

This memo is not designed to provide Boards with an exhaustive review of the Regulations but is an attempt to discuss those matters that may raise immediate questions. The Commission will provide other memos as well as educational seminars to assist Boards and staff as they deal with these Regulations. Ultimately, we hope to develop sample contracts and RFP’s.